THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE APRIL 2008

Note: In an effort to streamline its publishing program, the Department of Finance will cease publication of *The Economy in Brief* after this issue, as the data used in its preparation is available from public sources.

OVERVIEW

- In the fourth quarter of 2007 real gross domestic product (GDP) increased 0.8%, the slowest pace of growth since the second quarter of 2003. For the year as a whole real GDP increased 2.7%, down slightly from 2.8% in 2006.
- Real final domestic demand remained robust in the fourth quarter, rising 6.9%, its strongest growth rate in 11 years. Strong household and corporate balance sheets, together with a healthy labour market, continued to underpin domestic demand. Employment rose 2.9% in the fourth quarter, up from 1.7% in the third quarter. In February 2008, the unemployment rate remained at 5.8%, matching a 33-year low.
- Real exports fell while real imports grew strongly in the fourth quarter, contributing to lower GDP growth in the quarter and to a narrowing of the trade surplus. The current account declined from a surplus of $5.3 billion in the third quarter to a deficit of $2.1 billion in the fourth quarter, the first deficit in the current account since the second quarter of 1999. For 2007 as a whole, the current account registered a significant surplus of $14.2 billion or 0.9% of nominal GDP.

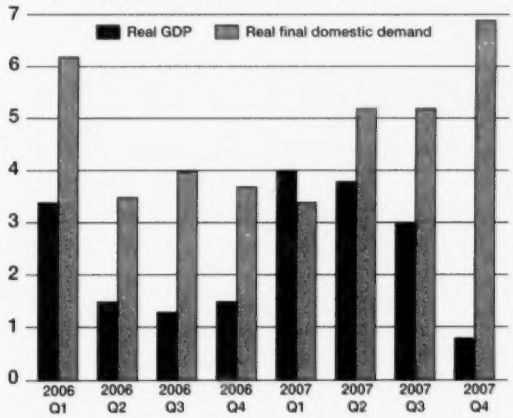
Real GDP increases 0.8%

Real GDP rose 0.8% in the fourth quarter of 2007. With real imports rising and real exports falling, growth in real final domestic demand accounted for the overall gain and outpaced growth in real GDP for the 12th time in the last 13 quarters (Chart 1).

Consumer spending grows sharply

Real consumer expenditure increased 7.4% in the fourth quarter, the strongest gain since the third quarter of 1985. Spending in all major categories rose.

Chart 1
Growth in real GDP and real final domestic demand
per cent (annual rate)



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. Incorporates data up to March 28, 2008.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2006	2007	2007:Q2	2007:Q3	2007:Q4		Most recent
Real gross domestic product	2.8	2.7	3.8	3.0	0.8		–
Final domestic demand	4.7	4.3	5.2	5.2	6.9		–
Government expenditure							–
Goods and services	3.3	3.6	4.1	6.2	6.9		–
Gross fixed capital	8.1	4.5	6.6	9.8	5.9		–
Consumer expenditure	4.2	4.7	5.8	4.5	7.4		–
Residential investment	2.1	3.2	6.5	5.5	2.4		–
Business fixed investment	9.9	4.4	3.3	5.5	7.2		–
Non-residential construction	12.9	3.9	-2.8	-2.4	0.4		–
Machinery and equipment	7.4	5.1	9.6	13.7	14.3		–
Business inventory investment ($ billion)	10.2	10.8	4.8	16.4	18.7		–
Exports	0.7	0.9	2.3	0.7	-8.5		–
Imports	5.0	5.7	7.3	18.4	10.9		–
Current account balance							
(nominal $ billion)	23.6	14.2	25.6	5.3	-2.1		–
(percentage of GDP)	1.6	0.9	1.7	0.3	-0.1		–
Nominal personal income	6.1	6.1	6.3	2.9	5.3		–
Nominal personal disposable income	6.4	5.6	2.6	4.9	6.4		–
Real personal disposable income	5.0	4.0	0.2	4.4	5.5		–
Profits before taxes	5.0	5.8	5.7	7.9	2.2		–
Costs and prices (%, y/y)							
GDP price deflator	2.4	3.1	3.4	2.8	3.9		–
Consumer Price Index (CPI)	2.0	2.2	2.2	2.1	2.4	1.8	Feb-2008
Core CPI[1]	1.9	2.1	2.4	2.2	1.6	1.5	Feb-2008
Unit labour costs	3.1	2.9	2.8	-2.4	5.8		
Wage settlements (total)	2.5	3.3	3.0	3.9	3.4	3.3	Jan-2008
Labour market							
Unemployment rate (%)	6.3	6.0	6.1	6.0	5.9	5.8	Feb-2008
Employment growth	1.9	2.3	1.5	1.7	2.9	3.1	Feb-2008
Financial markets (average)							
Exchange rate (U.S. cents)	88.2	93.5	91.1	95.7	101.9	97.90	28-Mar-08
Prime interest rate (%)	5.8	6.1	6.0	6.3	6.2	5.25	28-Mar-08

Note: Real values are in chained 2002 dollars.
[1] Core inflation excludes eight of the components of the CPI basket that display the greatest volatility, as well as the effect of changes in indirect taxes on the remaining components.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Social Development Canada.

Household spending was supported by personal income growth of 5.3%, up sharply from 2.9% in the third quarter. With gains in employment and wages, labour income jumped 7.3% after a 1.5% rise in the previous quarter.

In the fourth quarter, real personal disposable income rose 5.5% while per capita real personal disposable income increased 4.1%. The personal savings rate was 0.8%, down from 1.3% in the previous two quarters.

Residential and business investment grow

Residential investment rose 2.4% in the fourth quarter, less than half the pace in the third. Housing starts declined in the quarter, moderating growth in new construction activity to 5.4% from 10.2% in the previous quarter. Spending on renovations rose 5.0%. The home resale market, however, softened, reducing transfer expenditures by 10.1%.

Business investment in plant and equipment grew 7.2%, up from 5.5% in the third quarter. Spending on machinery and equipment increased 14.3%, a second consecutive double-digit gain, while non-residential construction rose 0.4%.

Increased business inventory accumulation

Businesses added $18.7 billion to inventories in the fourth quarter, up from $16.4 billion in the third, thereby contributing to real GDP growth in the quarter. Inventories of retailers and wholesalers rose significantly. With the accumulation in the quarter, the overall inventory-to-sales ratio increased, but remained well below its recent average.

Real exports fall while real imports rise, pushing the current account into deficit

In the fourth quarter, real exports fell 8.5% while real imports rose 10.9%. Real exports declined across major goods categories, reflecting weaker U.S. demand and the continued strength of the Canadian dollar.

Real imports rose in all major categories, except energy and automotive products. North American vehicle sales at dealers fell, reducing imports of parts for the production and export of cars and trucks. The overall import gain reflected robust domestic spending as well as lower relative prices for imported goods. Imports of services increased 37.1% as travel spending abroad by Canadians (including cross-border shopping) soared 84.4%.

Although the terms of trade improved in the fourth quarter as export prices fell less than import prices, the sharp decline in net export volumes resulted in a $7.6-billion narrowing in the trade surplus to $14.1 billion. Similarly, the current account declined by $7.4 billion from a surplus of $5.3 billion to a deficit of $2.1 billion, or 0.1% of nominal GDP (Chart 2).

Corporate profits increase more slowly

Corporate profits rose 2.2% in the fourth quarter after rising 7.9% in the third quarter. Stronger consumer spending boosted profits for retailers and wholesalers. However, weak sales hindered motor vehicle and parts manufacturers' profits while lower prices reduced the profits of primary metal manufacturers. Overall, profits as a share of nominal GDP decreased modestly to 13.7% in the quarter (Chart 3). While somewhat below the peak at the end of 2005, profit margins remain well above their historical average.

Consumer price inflation remains subdued

Year-over-year consumer price inflation was 1.8% in February 2008, down from 2.2% in January, partly reflecting lower prices for fruits and vegetables. Core CPI inflation, which excludes eight of the most volatile items and the effect of changes in indirect taxes, increased to 1.5% year-over-year in February from 1.4% in January. Core inflation has been below the Bank of Canada's 2% target since October 2007.

Chart 2
Current account as a percentage of nominal GDP

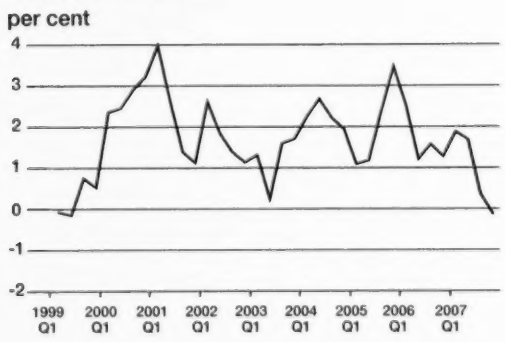
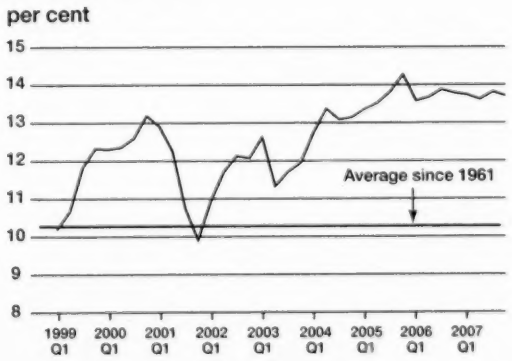


Chart 3
Profits before taxes as a share of nominal GDP



The GDP deflator, a comprehensive measure of the prices of goods and services produced in Canada (it includes export prices but excludes import prices), rose 4.5% in the fourth quarter following a 0.7% decrease in the third. The increase in the deflator largely reflects higher energy prices. However, final domestic demand prices (which include the effect of import prices), rose a little over 1%, as declining prices for imports dampened the impact of increased prices for domestically produced goods and services.

Unemployment rate remains low

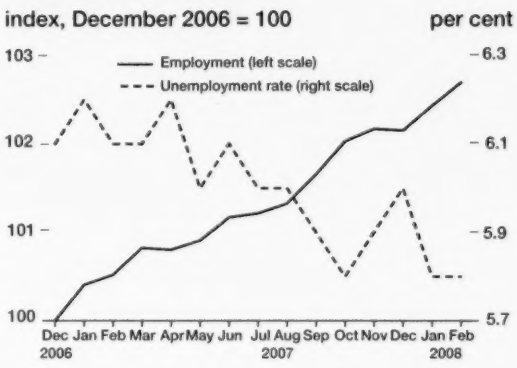
Employment grew 2.9% in the fourth quarter, up from 1.7% in the third quarter. With further gains in January and February 2008, net job creation stood at a healthy 447,800 since the end of 2006 (Chart 4), nearly 90% of which was in full-time jobs. In February, the unemployment rate remained at a 33-year low of 5.8%. The participation rate was at 67.8%, a record high.

Hourly labour productivity for the total economy fell 2.6% in the fourth quarter, following growth of 0.8% in the previous quarter. Labour costs per unit of output on a total economy basis were up 5.8% in the fourth quarter.

Bank of Canada lowers policy rate

On March 4, the Bank of Canada reduced its key policy rate—the target for the overnight rate—by 50 basis points to 3.5%. This followed cuts of 25 basis points on both December 4 and January 22. In its announcement following the March cut, the Bank noted that "the deterioration in economic and financial conditions in the United States can be expected to have significant spillover effects on the global economy. These developments suggest that important downside risks to Canada's economic outlook...are materializing and, in some respects, intensifying." The Bank also noted that "the balance of risks...for inflation has...shifted to the downside."

Chart 4
Employment and the unemployment rate



In response to credit market disruptions and a weakening economy, the U.S. Federal Reserve decreased the target for the fed funds rate by 75 basis points on March 18, bringing the total reduction to 300 basis points since September 2007.

Canadian dollar

High commodity prices, such as those for crude oil, continue to support the Canadian dollar. After hitting a modern-day high of 108.52 U.S. cents on November 6, 2007, the value of the Canadian dollar has since traded between 97 and 103 U.S. cents. It closed at 97.90 U.S. cents on March 28.

The main source of data used in this publication is Statistics Canada. For inquiries about this publication, contact Isabelle Amano at 613-992-4321. Also available on the Internet at www.fin.gc.ca.
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